IN THE

Supreme Court of the United States

77-260

October Term, 1977

No. 73-1921

ROBERT O. NAEGELE and ROGER A. PETERSON, Trustees in Voluntary Dissolution of NAEGELE ADVERTISING COMPANIES, INC., a Minnesota Corporation,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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OPINIONS BELOW

The matter was initially heard by the United States District Court for the District of Minnesota, Fourth Division, on June 15, 1973, before the Honorable Earl R. Larson. The citation to said case rendered on August 6, 1973, is 383 F. Supp. 1041 (D.C., Minn., 1973), 73-2 U.S.T.C. ¶9696. The opinion is included in the Appendix.

The instant case was appealed to the United States Court of Appeals for the Eighth Circuit and heard on May

17, 1977, before Circuit Court Judges Stephenson and Webster and District Court Judge Benson. The opinion of this case was unpublished and is included in the Appendix.

GROUNDS FOR JURISDICTION

Judgment of the United States Circuit Court of Appeals for the Eighth Circuit was made and entered on May 20, 1977. This petition was timely filed within 90 days of May 20, 1977. Jurisdiction of this Court is invoked pursuant to the provisions of 28 USC §1254.

QUESTION PRESENTED

1. Whether the excess of net operating loss over ordinary income in the relevant tax year survived to be carried forward when the alternative method of computing corporate income tax was used?

   a. Whether the definition of "taxable income" under IRC §63(a) is changed by application of a net operating loss under IRC §172 when the alternative method of corporate taxation is used?

   b. Whether in light of the holding in *Foster Lumber Company*, infra, net operating losses should be offset against capital gain under the alternative method of calculating corporate taxation?

STATUTES INVOLVED

The following provisions of the Internal Revenue Code of 1954 found in the Appendix, are the only applicable statutes:

1. IRC §11(a).
2. IRC §63(a).
3. IRC §172.
4. IRC §1201(a).

STATEMENT OF THE CASE

The taxpayer, Naegele Advertising Companies, Inc., instituted this proceeding through their trustees in voluntary dissolution, Robert O. Naegele and Roger A. Peterson, by filing a claim for refund of taxes erroneously assessed and paid in the amount of $195,788 for its 1963 tax year. The basis for such claimed refund lay in the Tax Court decision *Chartier Real Estate Co. v. Commissioner*, 52 T.C. 346 (1969), *aff'd per curiam*, 428 F. 2d 474 (1st Cir., 1970). *Chartier* held that net operating losses need only be offset against the ordinary income component of taxable income under the alternative method of corporate taxation and further that any excess net operating loss over ordinary income was available to be carried forward to other tax years if appropriate. The matter proceeded to the District Court, pursuant to Title 28 U.S.C. §1346(a)(1), on stipulated facts and cross motions for summary judgment. On August 6, 1973, the District Court by Judge Larson granted the taxpayer's motion for summary judgment. On December 26, 1973, the Government filed its notice of appeal to the Eighth Circuit Court of Appeals

where a decision in favor of the Government was rendered on May 20, 1977.

The facts were stipulated to below and are therefore not in dispute here. Taxpayer, a dissolved Minnesota corporation, and its subsidiaries incurred net operating losses in the tax years 1958, 1961 and 1965, the aggregate amount of which totaled $362,571. Pursuant to IRC §172 the net operating losses were respectively carried forward and back to 1962 where the taxpayer had incurred a capital gain of $2,881,913 and an ordinary loss of $146,-399. Upon recomputation of its tax, under both the regular and alternative methods, it was determined that the alternative method produced a lower tax and its use was therefore required. Since the net operating loss as applied to ordinary income (a loss of $146,399) in 1962 was totally unused, taxpayer pursuant to *Chartier*, supra, claimed the entire net operating loss should be carried forward to offset ordinary income in 1963. The Government contended that the net operating loss was actually offset against taxable income, i.e. ordinary income plus capital gain in 1962, and was therefore completely absorbed even though net operating losses cannot be used to offset capital gain under the alternative method of corporate taxation.

Over a number of years in addition to the instant case all cases upon this issue were decided in favor of the taxpayer. See *Chartier*, supra; *Olympic Foundry Co. v. United States*, 493 F. 2d 1247 (9th Cir., 1974); *Data Products Corp. v. U.S.*, unpublished (9th Cir., 1974); *Foster Lumber Company v. United States*, 500 F. 2d 1230 (8th Cir. 1974); *Continental Equities, Inc. v. Commissioner*, Dec. 32,692 (M) T.C. Memo 1974-189; *Axelrod v. Commissioner*, Dec. 32,107 (M) T.C. Memo 1973-190; and

Mutual Assurance Society of Va. v. Commissioner, Dec. 32,084 (M) T.C. Memo 1973-177. Thus, *Chartier*, supra, had been consistently upheld by District Courts, Appellate Courts and the Tax Court.

It was not until October 16, 1974, that *Mutual Assurance*, supra, was decided on appeal, adversely to the taxpayer, 505 F. 2d 128 (4th Cir., 1974). Taxpayer in that case had an extremely small claim and did not pursue the matter further. However, the Government citing the split among the Circuits sought a petition for certiorari in the *Foster Lumber* case, supra. All proceedings in the instant case were deferred pending resolution of the *Foster* case. On November 2, 1976, *Foster* was decided consistent with the Government's position by a 5-4 decision.

REASONS WHY THE WRIT SHOULD ISSUE

The Government's contention in *United States v. Foster Lumber Company*, infra, was that under the alternative method of calculating corporate taxation, net operating losses (hereinafter called NOLs) must be offset against taxable income in its entirety, i.e. ordinary income and capital gain, even though case law forbids the deduction of NOLs against capital gain. The effect of the Government's argument is that existing NOLs are eliminated or reduced by an illusory subtraction of NOL from the capital gain component of taxable income, without any consequent tax benefit to the taxpayer. In deciding *Foster*, infra, the Supreme Court adopted the Government's position and rejected the argument of *Chartier Real Estate Company v. Commissioner*, infra, relied upon by the taxpayer. *Chartier* held that the excess of net operating loss

over the ordinary income component of taxable income may be carried to subsequent tax years wherever possible, under the alternative method of calculating corporate taxation.

The Court's primary analysis in *United States v. Foster Lumber Company*, — U.S. —, 97 S.Ct. 204, 50 L.Ed. 2d 199, 45 L.W. 4001, (1976), that the term "taxable income" is redefined under the holding of *Chartier Real Estate Company v. Commissioner*, 52 T.C. 346 (1969) *aff'd* 428 F. 2d 474 (1st Cir., 1970), blinded the Court to other alternatives. In fact, it is quite easy to apply the section in question without any supposed redefinition. To do so, the word "modifies" from *Chartier*, which the *Foster* Court viewed as meaning "redefined" must be read as meaning "refers to". When this grammatical approach is taken, no change in the definition of "taxable income" need occur.

Although Petitioners believe and contend that the construction of §172(b)(2) urged herein is justified by the language of that section, Petitioners request that if such construction is not accepted, the Court grant the Petition for Certiorari to decide whether the principle announced in *Weil v. Commissioner*, 23 T.C. 424, *aff'd* 229 F. 2d 593 (6th Cir., 1953), and applied in *Chartier*, supra, has continued validity in light of *United States v. Foster Lumber Company, Inc.* The two former cases reasoned that a net operating loss could not be used to reduce long-term capital gain in computing the alternative tax provided by §1201(a).

A.

THE *CHARTIER* COURT DID NOT REDEFINE "TAXABLE INCOME" AS DEFINED AT IRC § 63(a).

Chartier Real Estate Company was viewed by the Court in the *Foster*, supra, case as redefining "taxable income". After stating the facts, Justice Stewart in the initial sentence of the opinion clearly stated his view that a "definitional" issue was involved. He said at 45 L.W. 4002:

> The dispute in this case centers on the meaning of "taxable income" as used in §172(b)(2) to govern the amount of carrybacks and carryovers that can be successively transferred from one taxable year to another.

Stewart made what was essentially his conclusion at the end of the first paragraph found at 45 L.W. 4002-4003:

> On its face the concept of "taxable income" thus includes capital gains as well as ordinary income. In the absence of a specific provision excluding capital gains, it thus appears that both capital gain and ordinary income must be included in the taxable income that §172 directs must be offset by the loss deduction before any loss excess can be found to be available for transfer forward to the succeeding taxable year.

With this premise in mind the Court found that application of a net operating loss in the *Chartier* fashion resulted in redefinition of taxable income. Near the end of the first portion of the opinion Stewart stated at 45 L.W. 4004:

> It is, of course, not unusual in statutory construction to find that a defined term's meaning is substantially modified by an attached clause. . . . Such a construction subtly redefines "taxable income" in terms

> of the tax impact of a particular method of a tax calculation. It thus implicitly departs from the 'term of art' definition of taxable income given in §63(a). . .

It is this conclusion to which Petitioners primarily object.

The Tax Court in *Chartier* was well aware of the definition of "taxable income" under the Code. It was not its intent to redefine the term "taxable income" but to indicate how net operating losses should be applied. In so doing the *Chartier* Court very carefully laid out is premises. It said at pp. 357-358:

> In the instant case, petitioner used, in computing its actual tax liability, i.e., in computing its tax by the "alternative" method provided in section 1201(a), $1,115.57 of its net operating loss to offset taxable income from the year ending June 30, 1962. In keeping with the purpose of section 172, the remaining $10,342.64 should be used to offset gains in other years to which it may be carried. We think that nothing in that section prohibits the carry-forward of that amount to the year ending June 30, 1965. The pertinent sentence in section 172(b)(2) is "The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried." We agree with petitioner's contention that the phrase "to which such loss may be carried" modifies "taxable income" as well as "each of the prior taxable years." We further hold that "taxable income" in this context (as modified by the above phrase) means that taxable income to which the loss is actually applied in computing actual tax liability. In this case, since the tax for petitioner's year ending June 30, 1962, was computed by the

> "alternative" method, the only taxable income to which the loss could be carried was the $1,115.57 of ordinary income for that year.

The most crucial portion of the above and the statement which the *Foster* Court misapplied, is the following:

> We agree with petitioners contention that the phrase 'to which such loss may be carried' modifies 'taxable income' as well as 'each of the prior taxable years'. We further hold that 'taxable income' in this context (as modified by the above phrase) means that taxable income to which the loss is actually applied in computing actual tax liability.

The word "modifies" is the critical word in the above quote. It could mean "redefined" as the Supreme Court read it in *Foster;* or it could mean "refers to", since a word or clause may modify another word or clause by referring or appertaining to it. In the latter case the essential definition or nature of the word or phrase modified does not change; however, additional information concerning the modified word or phrase is given by the modifying word or phrase. The *Chartier* decision in the part quoted above contains a grammatical explanation of how net operating losses should be applied. NOLs should be applied by carrying them to taxable income in prior tax years. Thus, grammatically *Chartier* said that the phrase "to which such loss may be carried" refers to (modifies), the phrase "taxable income" and also refers to (modifies), the phrase "each of the prior taxable years." *Chartier* did not "redefine" those phrases—it referred to them. Petitioners contend that the *Chartier* decision should be read in this latter fashion; i.e. that the phrase "to which such

loss may be carried" refers to both the phrases "taxable income" and "prior taxable years". Since no change in definition is involved in this analysis, the problem viewed by the Court never occurs. The only remaining question becomes what "taxable income" can be offset against the net operating loss? This is answered in the next sentence where the Court said,

> We further hold that 'taxable income' in this context (as modified by the above phrase) means that [*portion of*] taxable income to which the loss is actually applied in computing actual tax liability. (words added)

Once the statutory phrase in *Chartier* is read as above it becomes clear that the *Chartier* Court did not redefine "taxable income" but rather was attempting to construe the provision in a grammatical, utilitarian fashion and in light of the case law, i.e. *Weil* and *Chartier* issue one.

Clearly, under the dictates of *Chartier* "taxable income" is defined as ordinary income plus capital gain consistent with § 63(a). The *Chartier* Court essentially took a realistic approach to the subtraction process involved. It reasoned that NOLs must be applied against and reduce "taxable income" under IRC §172(b)(2). It further reasoned that NOLs cannot be used to reduce capital gain under the alternative method (*Weil* and *Chartier* issue one). Thus, to offset NOLs against taxable income (ordinary income plus capital gain) results in an illusory subtraction to the extent of the excess of NOL over ordinary income. While that portion is offset and consequently lost, no reduction or subtraction from capital gain has resulted. In the instant case, this is all the more painful since taxable income in the

1962 tax year was entirely composed of capital gain and consequently, no portion of the NOL was used. Thus, in reaching its result *Chartier* did not redefine terms but rather took a realistic approach to the subtraction process. Since the first holding of *Chartier* itself determined that net operating losses could not be offset against capital gain, the consequent result was logically mandated if the policy is that NOLs should be fully used.

When read as explained above, the decision is grammatically sound. No reason exists to read the phrase "to which such loss may be carried" as changing the definition of "taxable income". If *Chartier* is read as a redefinition of "taxable income", the decision itself becomes illogical since *Chartier* ruled that the phrase "to which such loss may be carried" modified both "taxable income" and "each of the prior taxable years". If the definition of "taxable income" was changed, then the definition of "prior taxable years" must also have been changed. No contention of this nature known to this writer has ever been made. Yet, if both phrases are modified by the same phrase and the definition of one is thereby changed, it is both logically and grammatically consistent that the definition of the other was also changed. In view of the utilitarian approach taken by the *Chartier* Court, such an assumption is illogical in itself. On the other hand, when the word "modifies" is read as "refers to" rather than "redefined", the above problem does not occur. The phrase "to which such loss may be carried" refers to and adds information about both of the phrases, "taxable income" and "each of the prior taxable years" but does not change their meaning or import. Other commentators have also adopted such an approach. At 29 Okla. L.R. 1010, 1017,

the author of a Note entitled *Taxation: Interplay of the Net Operating Loss Deduction and the Alternative Tax*, (1976), concluded:

> It is conceded that "taxable income" as used in Section 172(c) [*sic*] is the same as that defined in Section 63(a)—gross income minus deductions. However, a holding that the net operating loss carryback is carried only to the ordinary income portion of taxable income does not distort this definition. It is grammatically correct to read Section 172(c) [*sic*] so that the phrase "to which the loss may be carried" modifies "taxable income," and the entire phrase "taxable income . . . to which such loss may be carried" should mean the ordinary income portion of taxable income when the alternative tax is used. If the regular tax is used in a carryback year, it makes no difference which interpretation is made, because the net operating loss can be carried to the entire taxable income to effect a corresponding reduction in tax liability.

In *Foster*, supra, the Court by quickly deciding that "taxable income" was being redefined, never really came to grips with the simple logic of the *Chartier* Court. As such, *Foster* is a decision which is not logical either grammatically or practically. Its result is not logical, not grammatical, and not equitable.

The following argument should not be viewed as a concession or an indication of Petitioners lack of faith in their argument. The argument is presented to allow the Court to uphold its *Foster* analysis in part, but reverse the *Foster* result. It is the contention of Petitioners that the definition of taxable income under the *Chartier* case was changed so as to allow carryovers of NOLs in excess of

ordinary income. If this is correct, this Court should reverse the *Foster* result and concurrently affirm the Court's premise that the definition of taxable income was changed by *Chartier*. The result of such action would be to uphold the taxpayers position that NOLs should be fully used rather than arbitrarily lost and at the same time to recognize that the definition of "taxable income" was changed under *Chartier*. In effect, a new definition of taxable income usable only with the alternative method of calculating corporate taxation would be created.

B.

THE FIRST ISSUE OF *CHARTIER* SHOULD BE RE-EXAMINED.

Chartier contained two issues. The first was whether the net operating loss could be offset against capital gain under the alternative method of corporate taxation. If the construction of §172(b)(2) urged in the above argument is not accepted, the Court should grant the Petition and reject the principle followed in *Chartier*, supra, that a NOL cannot reduce the capital gain portion of the alternate tax provision, §1201a.

Consistency and equity require that if a NOL is absorbed by the capital gain portion of the alternative tax for the purpose of determining the amount of NOL to be carried to a subsequent taxable year, as required by *Foster Lumber*, the absorption actually result in a reduction, or elimination, of the corresponding portion of capital gain for purposes of computing the alternative tax. To hold that the NOL is offset by the capital gain and thus not available for use in subsequent years is justifiable only if the offset actually is given effect by reducing the amount of capital gain subject to taxation. There is no judicial so-

phistry involved in giving effect to the ameliorative purpose of the NOL provisions, particularly when the intent of such legislation is clear.

After *Foster Lumber,* supra, the rejection of the principle that a NOL cannot actually reduce capital gain subject to taxation would help taxpayers avoid the untoward timing consequences illustrated by counsel in that case. Rejection of the principle would also remove the fiction that a NOL is applied and absorbed in a manner which provides little or no relief from problems caused by the annual accounting period. Finally, rejection of the principle would provide symmetry under either the regular or alternative method of computing corporate tax.

CONCLUSION

For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the United States Circuit Court of Appeals for the Eighth Circuit.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 11. TAX IMPOSED.

(a) *Corporations in General.*—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

SEC. 63. TAXABLE INCOME DEFINED.

(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) [as amended by Sec. 317(b), Trade Expansion Act of 1962, P.L. 87-794, 76 Stat. 872]. *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to which loss may be carried.*—

(A) (i) Except as provided in clause (ii), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

(ii) In the case of a taxpayer with respect to a taxable year ending on or after December 31, 1962, for which a certification has been issued under section 317 of the Trade Expansion Act of 1962, a net operating loss for such taxable year shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

(2) *Amount of carrybacks and carryovers.*—Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed—

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

and the taxable income so computed shall not be considered to be less than zero.

(d) *Modifications.*—The modifications referred to in this section are as follows:

(2) *Capital gains and losses of taxpayers other then corporations.*—in the case of a taxpayer other than a corporation—

(B) the deduction for long-term capital gains provided by section 1202 shall not be allowed.

SEC. 1201. ALTERNATIVE TAX.

(a) [as amended by Sec. 8(g)(3), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960] *Corporations.*—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 821(a) or (c), and 831(a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of such excess, or, in the case of a taxable year beginning be-

fore April 1, 1954, an amount equal to 26 percent of such excess.

In the case of a taxable year beginning before April 1, 1954, the amount under paragraph (2) shall be determined without regard to section 21 (relating to effect of change of tax rates).

United States District Court
District of Minnesota
Fourth Division

Robert O. Naegele and Roger A. Peterson, Trustees in Voluntary Dissolution of Naegele Advertising Companies, Inc., a Minnesota corporation,

Plaintiffs,

vs.

United States of America,

Defendant.

ORDER

No. 4-72-Civ. 253

The plaintiffs have filed a motion for summary judgment.

Defendant has filed a cross-motion for summary judgment.

Oral argument was heard on June 15, 1973.

On all the proceedings, briefs and arguments herein,

IT IS ORDERED:

That the plaintiffs' motion for summary judgment be granted and the defendant's motion for summary judgment be denied.

August 6, 1973.

/s/ EARL R. LARSON
United States District Judge

Memorandum Attached.

MEMORANDUM

Plaintiffs are the trustees in the voluntary dissolution of the Naegele Advertising Companies, Inc. (hereinafter Naegele). On behalf of the stockholders of that corporation they allege that the Government assessed and collected taxes substantially in excess of that amount which Naegele owed for the year 1963. This Court's jurisdiction lies under 28 U.S.C. §1346(a)(1).

The parties have stipulated to the facts, as set forth in the Claim which Naegele filed with the District Director of the Internal Revenue Service in June 1971. In the 1962 tax year Naegele showed a substantial capital gain coupled with an ordinary loss. Further, Naegele had incurred net operating losses in 1958 and 1961 that were carried over and a net operating loss in 1965 that was carried back to 1962, pursuant to the provisions of §172(b)(1) of the Internal Revenue Code. 26 U.S.C. §172(b)(1). The total of the net operating losses carried back and carried over to 1962 amounted to $362,571. As required by law Naegele calculated its 1962 tax first under the

"normal" method provided for in 26 U.S.C. §11 and then under the "alternative" method provided for in 26 U.S.C. §1201.

Section 1201 requires the payment of the amount of tax derived from the "alternative" method of calculation if that amount is less than the amount derived from calculation under §11. Since Naegele's §1201 tax in 1962 was less than its "normal" (§11) tax, Naegele paid its 1962 income tax pursuant to that "alternative" tax provision.

Section 1201 provides for a tax which is the sum of a tax on the excess of taxable income for the year over net long term capital gain reduced by the net short term capital loss, plus twenty-five per cent of the net long term capital gain reduced by net short term capital loss. Thus the tax is actually twenty-five per cent of the net capital gain figure in any year in which the capital gain figure exceeds taxable income.

Section 172(b)(1) permits corporations to carry net operating losses back three years and forward five years from the year of the loss. Once it has been determined to which year the loss will be carried under the regulation, the loss is then subtracted from that year's taxable income. The carryback-carryover net operating loss figure was utilized by Naegele in the calculation of its §11 tax. Naegele, however, determined and actually paid its 1962 tax pursuant to §1201.

In 1962 Naegele's net long term capital gain reduced by its net short term capital loss exceeded its taxable income. Thus the §172 net operating loss carryback and carryover provisions did not affect the calculation of the tax actually paid by Naegele in 1962.

Naegele now argues that, since its net operating loss carryback and carryovers were not utilized to reduce its taxable income in 1962 it should be permitted to carry that loss forward to 1963, to offset taxable income in that year to the extent allowed by the law. The Government contends that the aggregate net operating loss may not be carried forward because it was used to calculate the §11 tax and does not exceed the amount of taxable income in 1962. The Government's position was rejected in *Chartier Real Estate Co. v. Commissioner*, 52 Tax Ct. 346 (1969), *aff'd* 428 F. 2d 474 (1st Cir. 1970).

This Court follows *Chartier* for the reasons set forth in the tax court's opinion. In the present case there is better reason to grant the taxpayer relief than in *Chartier*. Here the taxpayer did not benefit from any portion of its aggregate net operating loss.[1] In *Chartier* the taxpayer had some ordinary income against which to offset its net operating loss carrybacks. When the taxpayer sought to carry the "unused" portion of the aggregate net operating losses to the consecutive tax year the court held it be an exaltation of form above substance to deny the taxpayer the benefit of these carrybacks simply because the loss was one of the figures employed in a method of calculation under which no tax was paid. This Court concurs.

The Government has discussed at great length the "rediculous consequences of taxpayer's position," and has demonstrated that under certain hypothetical circumstances, one dollar in net operating loss could result in

[1]As noted above, taxpayer had no ordinary income in 1962. As pointed out in *Chartier*, net operating loss carrybacks and carryovers will not be allowed to offset capital gains. Thus aggregate net operating losses are of benefit to the taxpayer only to the extent to which it has ordinary income in the year to which the losses are carried.

thousands of dollars in taxes to the taxpayer. The Court would point out two difficulties with the Government's position. The tax laws and regulations are replete with line-drawing rules and mechanisms, many of which will produce drastically different tax results with the addition or subtraction of one unit measure. Secondly, in tax matters a court must deal with the facts and equities present in the case before the Court, not with imaginary fact situations.

As a consequence of this Court's holding, Naegele is allowed to carry its aggregate net operating loss from 1962 to 1963, and its 1963 tax is that reflected in paragraph 16 of the Stipulations of Fact filed in this matter.

EARL R. LARSON

ORDER OF REVERSAL

Submitted: May 17, 1977

Filed: May 20, 1977

Before STEPHENSON and WEBSTER, Circuit Judges, and BENSON,* District Judge.

Upon careful consideration of the record and of the briefs and arguments of the parties, the court has concluded that the judgment of the district court[1] must be reversed in view of the subsequent decision of the Supreme Court in *United States v. Foster Lumber Co.*, 97 S. Ct.

*The Honorable Paul Benson, Chief Judge, United States District Court, District of North Dakota, sitting by designation.

[1]The Honorable Earl R. Larson, United States District Judge, District of Minnesota.

204 (1976), wherein the Court resolved the same net operating loss issue in favor of the government.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit

(Unpublished)

No. 77-260

In the Supreme Court of the United States

OCTOBER TERM, 1977

ROBERT O. NAEGELE AND ROGER A. PETERSON,
TRUSTEES, ETC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.,
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In the Supreme Court of the United States

OCTOBER TERM, 1977

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners[1] ask this Court to reconsider *United States* v. *Foster Lumber Co.*, 429 U.S. 32, which held that a taxpayer may carry a net operating loss deduction to a succeeding taxable year only to the extent it exceeds the taxpayer's total taxable income (*i.e.*, ordinary income and capital gains) in the prior year in which the Section 1201 alternative tax is employed. On the authority of *Foster Lumber Co.*, the court of appeals concluded that Naegele Advertising Companies, Inc., could not carry

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[1]Petitioners are trustees in voluntary dissolution of Naegele Advertising Companies, Inc., whose tax liabilities were at issue in the courts below.

forward from 1962 to 1963 net operating loss deductions of $362,571, because that amount was less than its taxable income for 1962 (Pet. App. A-8 to A-9).[2]

Petitioners do not dispute that *Foster Lumber Co.* squarely controls this case but contend that *Foster Lumber Co.* was wrongly decided. However, the Court fully considered and rejected the arguments advanced by petitioners. There is accordingly no occasion for the Court to reconsider *Foster Lumber Co.*

Petitioners alternatively urge (Pet. 6) that the Court grant certiorari to review the rule of *Weil* v. *Commissioner*, 23 T.C. 424, affirmed, 229 F. 2d 593 (C.A. 6), that in computing the Section 1201 tax, an individual taxpayer may not offset an ordinary loss against capital gains. But petitioners did not raise this question in their claim for refund or in the courts below. It would therefore be inappropriate for this Court to consider the issue.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

SEPTEMBER 1977.

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[2]For 1962, without reference to the losses carried to that year, Naegele had a net ordinary loss of $146,399 and a net long-term capital gain of $2,881,913, for net taxable income of $2,735,514 (Pet. 4).